

Top Secret 217

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NATIONAL INTELLIGENCE DAILY CABLE

Monday February 14, 1977

CG NIDC 77-036C

State Department review completed



NATIONAL SECURITY INFORMATION

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National Intelligence Daily Cable for Monday February 14, 1977.

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LEBANON-PALESTINIANS: Restrictions

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[] The series of new restrictions on Palestinian activity in Lebanon apparently agreed to on Saturday by the quadripartite committee--representatives of Syria, Egypt, Saudi Arabia, and Kuwait charged with overseeing the Lebanese ceasefire--appear designed to bring the fedayeen movement under closer Syrian control and to limit the ability of the Palestinians to obstruct the peace process.

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[] Under the new curbs, put forth in what is said to be a new agreement on applying the Cairo accord of 1969, which governs the fedayeen presence in Lebanon, the fedayeen would be prohibited from possessing arms or ammunition outside "specified border regions" near Israel. Armament in the refugee camps would be restricted to "light, individual weapons" to be carried by the Palestine Armed Struggle Command, the Palestinian police force. Rallies, demonstrations, and statements to the press would require authorization at least 24 hours beforehand from the Lebanese authorities. Fedayeen-operated radio stations would not be permitted.

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[] The ban on all but "light" weapons in the refugee camps would appear to be aimed primarily at the "rejectionists." Syria had earlier permitted the more moderate Palestinian groups to move into southern Lebanon, leaving the "rejectionists" occupying the camps in the north and central areas of the country.

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[] The largely Syrian Arab peacekeeping forces may, in fact, be preparing to move against the camps near Beirut to seize the heavy weapons held by the "rejectionists." In an apparent reference to the camps, the Saudi representative to the quadripartite committee said on Saturday that "next week will be the week of raids." Yesterday Palestinian leaders charged that Arab peacekeeping forces were massed around the refugee camps.

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[] The new restrictions also would reportedly limit the Palestinians in Lebanon to the number registered with the UN in 1969. It is doubtful that this restriction, which would force some 150,000 of the 350,000 Palestinians in Lebanon to leave, can be put into effect anytime soon. []

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ITALY: New Labor Law

25X1 [] Leaders of the major Italian political parties and labor unions have expressed dissatisfaction with the new law aimed at reducing labor costs. The law, decreed by the Andreotti government on February 4, must still be ratified by parliament, where portions of it could face opposition. It seems likely, however, that a somewhat modified version of it will be approved.

25X1 [] The sources of dissatisfaction with the new law--which was intended by the government to supplement the two-week-old labor-management agreement on controlling labor costs--are varied. Some of the ruling Christian Democrats joined the Republicans in criticizing the government for not taking more forceful action to reduce the inflationary effects of the wage-escalator mechanism.

25X1 [] The Communists and Socialists, on the other hand, are distressed at the government's failure to discuss beforehand with parliamentary leaders the nature of certain tax measures, as well as the penalties included for companies agreeing to plant-level wage increases in excess of those provided for in national contracts. Besides seconding the Communists' and Socialists' complaints, trade union leaders are especially irked that the new law prohibits the value-added tax increases from being reflected in wage rates via the cost-of-living escalator.

25X1 [] Although there was an initial angry labor reaction prompting an outbreak of localized strikes, national labor federation leaders--with strong backing from both the Communists and Socialists--vetoed a nationwide general strike. Instead, they decided to rely on leaders of the political parties--with whom they will meet on Wednesday--to modify the objectionable parts of the decree law during parliamentary debate.

25X1 [] Despite the criticism, all parties know that failure to ratify the law could jeopardize Italy's efforts to obtain financial support from the International Monetary Fund and the European Community and might also precipitate a government crisis. They will therefore be under considerable pressure to vote for it or abstain.

25X1 [] Moreover, Prime Minister Andreotti--who expects action on the decree law within two weeks--has already displayed some

sensitivity to the parties' complaints by expressing his willingness to make further modifications. Christian Democratic party secretary Zaccagnini has even broached the possibility of the parties' parliamentary leaders' resolving outstanding differences.

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[] Up to now, only the Republican Party has threatened to vote against the measures, and this may be just a tactical move. The other parties are seeking further clarifications of the cabinet decision and probably will attempt to modify the law during the debate.

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[] The Communists will probably push for some changes in the decree law, but seem likely to abstain in the vote to avoid any threat to the government. []

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EGYPT: Containing Consumer Pressures

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[] During the last week in January, rioting by Egypt's normally docile population focused international attention on the political-economic tightrope that President Sadat is walking. The rising expectations of the people constitute the most pressing problem facing Sadat and any successor regime.

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[] For almost a decade, the discontent among urban Egyptians was kept under control by the threat of war. Both Nasir and Sadat were prevented by a lack of foreign exchange from increasing consumption in the import-dependent economy and therefore blamed economic hardship on the confrontation with Israel, in effect promising a better life when the confrontation ended.

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[] To the average Egyptian, however, the Sinai II agreement of 1975 marked the end of war and the beginning of a perplexing new economic era. Relaxation of the economic restrictions imposed under Nasir exposed Egyptians for the first time in two decades to the conspicuous consumption of a rich elite and to the uncertainties of market forces.

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[] For a time, the opportunities offered by growth in the private sector offset both the effect of the excesses of the newly rich and the impact of worsening inflation. Public tolerance, however, was pushed past the limit last month by

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the government's badly bungled attempt at further economic reform. By summarily slashing consumer subsidies--many of which had been in place since 1948--Cairo forced consumer prices sharply upward. Sadat restored the subsidies when serious rioting erupted.

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[] Sadat now undoubtedly expects substantial amounts of new cash aid from conservative Arab states to bolster his regime in the wake of the disorders. Even if the new aid tally is disappointing, Egypt has still begun 1977 in far better financial shape than it did in 1975 or 1976. Thanks largely to rising Egyptian oil output and the resumption of subsidy payments from other Arab states, Cairo faces an unfinanced foreign payments gap this year of \$1 billion at most, compared with \$2 billion last year.

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[] Most of Cairo's 1976 overdue debt service payments have been paid off with a \$250 million direct loan from the newly established Gulf Organization for Development of Egypt and a \$250 million bank loan guaranteed by the same organization. In addition, \$570 million in Arab subsidies have been authorized for 1977, and another \$570 million in retroactive 1976 payments may be approved. Other subsidies from Arab donors, US aid, project aid from other sources, and some private investment will provide another \$1.4 billion.

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[] Armed with the expectation of ample aid but threatened by the prospect of further civil unrest, Sadat is now seeking to modify the economic reform package proposed by the International Monetary Fund. The terms of the package--currency devaluation, reduced subsidies, and other measures--are designed to realign domestic prices, reduce the role of the public sector, and control inflation. They will also result in reduced consumption over the short run.

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[] The political risks to Sadat of such measures have been considerably multiplied by his loss of stature during the January riots. On the other hand, Sadat feels he can now dilute the reform program and still count on conservative Arab states to come up with new cash aid to bolster his regime.

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[] A slowdown in implementing the IMF reforms will force Egypt to continue to depend heavily on foreign aid rather than private foreign capital. During the 1978-80 period, at least \$5

billion will be needed to finance the foreign exchange component of investment in plant and equipment. Another \$5 billion in balance-of-payments support or debt relief will be required to provide a small increment in urban consumption levels and to permit some progress in renovating Egypt's economic infrastructure. Much more substantial foreign aid will be needed if expectations for Egypt's major export industries, especially oil and tourism, are not realized.

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[REDACTED] //The oil sector is the main question mark. Since 1967, exploration and development activity in the Gulf of Suez area has been subject to Israeli harassment and to the threat of Israeli drilling in concessions let by Egypt to foreign oil companies. Unless it can freely exploit the Gulf of Suez, Egypt's oil revenues in 1980 may drop to \$900 million (at 1976 prices) instead of the \$1.4 billion projected until recently by Egyptian planners.

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[REDACTED] //Lags in hotel construction and in expanding the Suez Canal, moreover, could easily cause eventual earnings to fall below plan. Export shortfalls might well cost Egypt as much as \$3.5 billion in foreign exchange earnings over the next four years.//

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[REDACTED] Even if foreign exchange supplies are ample, Egypt's ability to increase imports will be limited for several years by bottlenecks in port capacity and the internal distribution system. In turn, import constraints will limit the growth of the economy and of consumption. [REDACTED]

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DENMARK: Election Forecast

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[REDACTED] //The Danish election tomorrow will probably result in few changes in the present parliament, and the current minority Social Democratic government will probably continue in office.//

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[REDACTED] //Prime Minister Jorgensen called the election when it appeared that he would have to rely on one-vote majorities on several important and controversial bills. With recent polls running in his favor, Jorgensen hopes to increase the parliamentary representation of his Social Democrats.//

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[] //During its two years in office, Jorgensen's government has been forced repeatedly to seek intricate compromises in parliament with five center-right parties. The large Liberal Party--second in size to the Social Democrats--finally refused to go along on a four-part legislative package that included a four-year defense budget plan, a new housing policy, an employment program, and a tax scheme to finance the other measures. The package could probably have been approved without the Liberals' votes, but the Prime Minister wanted a broad commitment from parliament on issues certain to have only limited support among substantial elements of the electorate.//

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[] //Nearly all political observers agree that the Social Democrats and the parties of the extreme right and left will make gains tomorrow. The parties of the center-right, primarily those that have supported the government for the past two years, are expected to lose parliamentary seats--but probably not enough to make much difference.//

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[] //The governing Social Democrats, by gaining seats, would strengthen their leadership role among the smaller parties. Such a gain would also run counter to the recent trend in Scandinavia that has brought more conservative governments to power in Iceland and Sweden.//

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[] //There is an outside chance that the Social Democrats could be forced into a formal coalition with the Liberals if two or more of the smaller center parties are soundly defeated in the election, but most members of the present government are acting as if they expect to remain in power.//

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[] //Prospects for a new defense budget plan and Denmark's participation in the four-nation consortium established to purchase and co-produce the F-16--the two issues of direct US interest that might be affected by the election--appear favorable. If the Social Democrats can establish a good working relationship with the Liberals after the election, which seems likely if the Liberals lose seats as expected, the stalled four-year defense budget plan probably will be passed.//

25X1 [] //A Danish Foreign Ministry spokesman assured the US embassy recently that a new plan would be passed by April 1, the expiration date of the current budget.//

25X1 [] //The F-16 project, on the other hand, could become a problem later if the Danes fail to get the promised 58-per-cent share of offset contracts to produce the new aircraft. To prevent the F-16 from becoming a political issue, the spokesman said the contracts should help develop Danish technology and know-how as well.// []

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PORTUGAL-EC: Membership Prospects

25X1 [] Portuguese Prime Minister Soares appears convinced that EC members will ultimately accept Portugal's application for full membership in the Community without an association period. He recognizes, however, that despite this political commitment, any steps to integrate Portugal into the Community are still many years away.

25X1 [] The EC foreign ministers last week formulated a common position in preparation for Soares' tour of EC capitals, which begins with a visit to London today. The ministers decided to accept Portugal's right to apply for full membership, but made it clear that extensive studies of the problems of economic integration must be made before a date can be set for beginning the time-consuming negotiations for membership.

25X1 [] In presenting their case for full membership in the EC, the Portuguese have taken an unusually hard line:

--The Portuguese ambassador to the EC told Community officials last week that reluctance to accept Portugal as a member would destroy Soares politically and drive the country back to a right-wing dictatorship.

--Foreign Minister Medeiros Ferreira recently said that Portugal would accept only full membership and would reject any form of association status.

--Portuguese ambassadors to EC countries, after a strategy session in Lisbon last week, implied that EC rejection or

qualification of the membership bid of a democratic nation would expose the EC as a group of countries unwilling to share their privileges.

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[] The Portuguese have countered the arguments of EC members that Portugal is not economically prepared to join the Community by stressing the political benefits of a commitment for eventual membership and arguing that Portugal is too small to have any detrimental effect on the Community's economic situation.

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[] The Portuguese objective in aiming for an EC commitment to full membership has been to foster the image at home of widespread European support for the efforts of Soares' minority government. Although early entry seems to be precluded by last week's decision in Brussels, the promise of eventual full membership may, nevertheless, have a favorable psychological effect on economic recovery and reduce the possibility of attempts from the right or the left to overthrow the Socialist government.

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[] Soares probably hopes a successful foreign policy will overshadow growing domestic discontent with his government's reluctance to take the necessary measures to improve the economy. This could involve some risk since the Community may also insist on difficult domestic measures. []

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Approved For Release 2006/03/17 : CIA-RDP79T00975A029800010024-5

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